STATEMENT

OF

JAMES E. MAURIN

On Behalf Of

The International Council of Shopping Centers

And

The Real Estate Roundtable

TO

THE SUBCOMMITTEE ON FEDERALISM AND THE CENSUS

OF THE COMMITTEE ON GOVERNMENT REFORM

OF THE

U.S. HOUSE OF REPRESENTATIVES

REGARDING

LANDS OF LOST OPPORTUNITY:
What Can Be Done to Spur Redevelopment At America's Brownfield Sites?

April 5, 2005

Mr. Chairman and members of the Subcommittee, my name is James E. Maurin. I am a founder and current Chairman of Stirling Properties of Covington, Louisiana. Stirling Properties manages a real estate portfolio of over seven million square feet. At Stirling, we have revitalized at least half a dozen properties that included some portion that qualified as a brownfield. I am testifying here today on behalf of The International Council of Shopping Centers and The Real Estate Roundtable.

I am also Chairman of the International Council of Shopping Centers. Founded in 1957, the International Council of Shopping Centers (ICSC) is the global trade association of the shopping center industry. Its more than 50,000 members in the U.S., Canada, and more than 96 other countries represent owners, developers, retailers, lenders, and other professionals as well as academics and public officials.

Shopping centers are America's marketplace, representing economic growth, environmental responsibility, and community strength. In 2004, shopping center-inclined retail accounted for $1.9 trillion in sales, or 76% of all U.S. non-automotive retailing, and produced $84.3 billion in state sales taxes. Each month, 203 million adults shop at shopping centers - 94% of the adult U.S. population. In addition, there were 17.6 million retail and real estate leasing or "shopping center-related" jobs nationwide, about 14 percent of non-agricultural jobs in the United States.

In addition, I am honored to be a member of the Board of Directors of The Real Estate Roundtable. The Real Estate Roundtable is a federal policy organization comprised of real estate industry leaders. Its members are the Chairmen, Presidents or Chief Executive Officers of the nation’s 100 leading commercial and multifamily firms, and the Managing Directors of major financial institutions. The Roundtable also includes the elected membership leaders of Washington's major real estate trade organizations. It serves as the vehicle through which industry leaders come together to identify, analyze and advocate policy positions on issues important to real estate. Collectively, Roundtable members hold portfolios containing over 5 billion square feet of developed property valued at more than $700 billion.

Thank you for this opportunity to appear before you today.

OVERVIEW

Today, there is a hard won consensus on the many benefits of environmentally "recycling" entire properties so that they can be placed back into productive use. Indeed, the business case for this environmentally responsible form of development can be compelling. To be sure, there are continuing concerns among some investors and lenders about the uncertainties associated with this type of development. For that reason, in some cases, the availability of a relatively small number of *additional* dollars — committed to cleanup costs — can be the difference between a "Go" and a "No go" decision by the project investors. Nonetheless, the public policy trends at the local, state and federal level are generally positive. Government is finding a way to be part of the solution and not merely one of the perceived "barriers" to success.

Fortunately, policymakers at *all* levels of government are coming to agree that so-called "brownfield" properties present as much an *opportunity* as a problem. The opportunity is to combine real estate development with environmental restoration in such a way that the economics – not lawsuits – are the driving force behind the cleanups. Working in partnership with our industry, mayors, state environmental officials and the EPA have all found constructive ways to increase the quantity and quality of brownfield redevelopment projects nationwide.

As the threat of excessive environmental liability recedes, the remaining problem with most well-located brownfield sites is a fairly simple one: *money*. Other things being equal, it costs more to cleanup and redevelop a brownfield that it does to simply buy and develop a "greenfield." Let me be clear. Real estate development, like any other business venture, will invest in projects only where the economic justify it. While many real estate developers are members of the communities in which they work and often have a vision for transforming their communities in an economic, aesthetic and socially positive way, if the numbers don't add up, it is very difficult to proceed with the project. Capital will be scarce and expensive and tenants may not be willing to pay the rent required to make the project a success.

One of the first things to be determined in any brownfield redevelopment is "does it make economic sense to put a development in this location." The private sector is often better equipped to make that determination than government officials on their own. If the private sector is not brought into the effort from the very beginning, market insights may be missed and costly mistakes could occur.

There are many new tools for those real estate companies and local communities seeking to redevelop their brownfield properties. These range from prospective purchaser liability relief to grant programs and tax incentives. Furthermore, many states have user-friendly brownfield programs in which the state provides prospective developers with helpful guidance as to how to go about acquiring, remediating and permitting. Today, we have been asked to consider what the government can do to enhance the existing incentive structure that has arisen to encourage brownfield redevelopment.

While many brownfields are candidates for re-development, not every brownfield presents a realistic real estate opportunity. The three most important considerations of any real estate deal are, as the cliché reminds us: location, location, location. Additionally, zoning, infrastructure, transportation, neighboring properties, proximity of available workforce are other considerations that come into play. If a brownfield is not strategically located it does little good to target it for redevelopment through government incentives. We don't think brownfield policies can — or should — transform a dog of a property into a goldmine. Instead, we believe appropriate incentives can help bring an otherwise sound development project out of the shadows of environmental stigma so that it can compete on a level playing field with other alternatives available in the marketplace.

Role for Federal Policy in Helping to Ensure the Success of State Brownfield Programs

Following a series of national stories highlighting dangerously polluted sites, Congress passed the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA or Superfund Act). With its unprecedented use of a combination of strict, retroactive and joint-and-several liability, Superfund made every past and present property owner fully responsible for all costs to clean up environmental contamination. Unfortunately, no one predicted at that time what later became very apparent: no one wanted to purchase and redevelop contaminated property when ownership meant overwhelming Superfund liability.

Superfund was intended to be a tough response to tough sites. At the time, little thought was given to how to handle lightly or partially contaminated properties. It took several years for the federal government to admit that most sites were not heavily contaminated and could be dealt with in a more cooperative manner than with traditional Superfund sites.

During the 1980s and 1990s a number of states, principally those with a history of industrial and manufacturing activity, began experimenting with voluntary clean up programs. When responsibly administered, these programs proved to be winning propositions. They were a win for local communities looking for redevelopment and the economic stimulus and jobs that come with new investment. They were a win for the environment as polluted sites were cleaned up after lying dormant for decades. Finally, they were a win for the new breed of real estate companies that had business plans designed to redevelop property that was stigmatized by historic pollution but which could be cost-effectively "recycled."

While these state programs began to show measurable progress in the cleanup of brownfield sites, federal policymakers struggled to ensure a constructive role for the EPA. Years of careful negotiation and balancing of sensitive interests came to a very positive conclusion on December 20, 2001, when the House adopted (unanimously) and the Senate also passed "The Brownfields Revitalization and Environmental Restoration Act of 2001" (BRERA). President Bush signed the bill into law on January 11, 2002 declaring it an example of "the best of Washington" — a model for what bipartisan environmental policymaking can achieve.

One aspect of the new Brownfields legislation has been to codify many elements of the state-federal partnership agreements — known as Memorandums of Understanding (MOU) or Memorandums of Agreement — that govern EPA's role in supporting these state voluntary clean-up programs. While these MOUs initially suffered from an impulse toward micro-management on the part of EPA, that is no longer the official *policy* of that Agency regardless of whether some individuals or offices behave otherwise.

Certainly, there remain incidents of federal or state officials not working together constructively on brownfield issues. Nonetheless, the general trend line has been *very* positive over the past few years.

Other Key Elements of the new Brownfields Law

The new Brownfields law modified CERCLA, the original Superfund liability law, to encourage brownfield development by providing federal liability relief to prospective purchasers of brownfield properties and to persons who undertake cleanups of these properties under state law. It also authorizes funding both to state brownfield programs and to local governments that seek to return brownfield properties to productive use. This relatively new law serves two functions. First, it creates a funding mechanism to assist state and local government efforts to redevelop specific brownfield sites and to aid states in administering their voluntary cleanup programs. Second, it provides relief from liability under CERCLA for new purchasers of contaminated properties, property owners and others who conduct cleanups under voluntary cleanup programs, as well as the owners of properties that are affected by contamination migrating from contiguous sites.

In the past, concerns about CERCLA liability have discouraged many property owners, developers and lenders from getting involved with brownfield projects. BRERA's liability reform provisions are intended to allay those concerns by providing substantial protection for new purchasers and property owners undertaking voluntary cleanup. But the liability reform protections are not absolute: each comes with qualifications and exceptions, so that the federal government may take enforcement action in unusual cases. Part of this new regime is an updated benchmark for determining when a purchaser of property may take title free of past pollution liabilities. Part of the regulatory process for clarifying this new benchmark was the development of new purchaser due diligence requirements, known as the All Appropriate Inquiry standards. Notably, ICSC and RER participated in the discussions that led to these new standards. Although still not perfect, the very existence of liability protections (even though incomplete) has begun to encourage purchasers and developers to undertake brownfield projects.

What Remains To Be Done

Given these recent improvements in the situation, what is left for the federal government to do in order to avoid any more lost opportunities? Many have argued that the EPA Brownfields Program is under funded and that hundreds of worthwhile projects have been turned down for cleanup-related grants in the past year alone. BRERA added section 104(k) to the Superfund law and thereby authorized up to $200 million in annual funding. However, in Fiscal Year 2004, these grants totaled only about $75 million. Clearly, there is a shortfall in the funding available under this law to local governments, states, Native American tribes and non-profit organizations.

And state contributions, while vital, also have often been less than completely dependable. For example, it has taken the state of New York over 18 months to agree to release $30 million worth of cleanup-related funding that had previously been set aside for brownfields. Fifty-two projects across the state have had their initial funding, for such activities as site assessment and planning, delayed. This financial uncertainty is a major reason why many developers refuse to consider participating in brownfield redevelopments.

The Federal and State governments should reconsider their tentative financial support for brownfield redevelopment. Properly conceived, brownfield redevelopments are <u>*investments*</u>, whether undertaken by the public or private sector. And there are few investments of public dollars that produce such a positive economic and environmental dividend. A simple calculation of how much it costs the federal Treasury to offer a grant, a loan, or a tax incentive is incomplete without factoring into the equation the future jobs and tax revenues that will be created during and after a brownfield cleanup.

A recent study by the U.S. Conference of Mayors found that brownfield cleanups led to an increase of $90 million in local tax revenues in 45 cities. Cleanups also were responsible for helping to create over 83,000 new jobs in 74 cities. A survey of 150 cities estimated that cleaning up their brownfield sites would produce as much as $1.9 billion in new tax revenues and nearly 600,000 jobs. [“Recycling America’s Land Report: A National Report on Brownfields Redevelopment, Volume IV”]

With so much at stake, local governments have been eager to work with private developers to revitalize brownfields. This does not alter the fact that developing a brownfield site is more complex and costly than developing a comparable uncontaminated site. Obviously, economic incentives can make the difference.

One method that has been discussed for bolstering the existing federal grant and loan program for non-profits and state entities is to offer tax incentives to offset the costs of cleanup by private companies. Many developers have experience with the federal Low Income Housing Tax Credit program. Building low income housing, with its lower rents and reduced sales prices, is generally a less attractive investment opportunity when compared to middle or upper income housing on the same site. So the Tax Reform Act of 1986 offered developers incentives in the form of tax credits against the income from low income housing. Developers may sell the credits to other investors to raise additional capital. By reducing the amount of borrowing required to acquire or rehabilitate residential units, tax credits contribute to the affordability of housing. This program has unquestionably resulted in a tremendous number of low income housing units being built and these units now are found across the country in almost every community.

Congress is generally reluctant to create new tax credits. There is a well-founded fear that excessively generous tax credits would distort a healthy market. But that is not to say that tax credits cannot be carefully designed and targeted to address specific problems. Last year, ICSC and the Roundtable examined a proposal originated by Chairman Turner, The Brownfield Revitalization Act (formerly H.R. 4480), which would dedicate a limited dollar amount for tax credits tied to the costs of remediating brownfield contamination. We feel that this proposal has the potential to stimulate numerous small and medium cleanup projects around the country. As with the Low Income Housing Tax Credits program, the private sector would still provide much of the necessary funding for cleanup. But the availability of a tax credit could tip the scales in favor of proceeding with a project, rather than passing over an otherwise promising site.

Brownfield Revitalization Act of 2005 Summary (formerly H.R. 4480)

Under this proposal, which we expect to be reintroduced soon, tax credits would be available for up to fifty percent of the remediation costs, including both demolition costs and the cost of cleaning up petroleum contamination. Later, I will go into more detail as to why these two aspects are so important. The tax credits only would be available under projects conducted pursuant to a state-approved remediation plan. Making these credits transferable to third parties, such as banks, would leverage the capital necessary for cleanups.

Last year's proposal would allocate up to $1 billion in tax credits among the states based on population. State development agencies would be authorized to administer the program. These credits would be further limited to redevelopment projects within a jurisdiction that includes at least one census track with poverty in excess of twenty percent. The states would apply various criteria to determine eligible projects, such as the extent of contamination remediated, the poverty at the location of the project, the number of jobs created, the position of the property within the central business district and the owner's financial commitment for redevelopment.

While the tax credit approach could benefit even large-scale remediation projects, I suspect that it would prove most valuable to small and medium scale cleanups where funding options can be even more limited. We should not underestimate the contribution that small scale projects can make to the economic vitality of a community.

A second valid approach to creating sufficient incentives for brownfield remediation would be to extend Section 198 of the Internal Revenue Code which allows the expensing of cleanup costs. Even better, as a method to increase economic certainty, would be to make the expensing provision permanent. Indeed, H.R. 877, introduced by Rep. Weller, Rep. Becerra and Rep. Johnson (CT), would accomplish precisely that, and more. H.R. 877 would do three things:

- Make permanent Internal Revenue Code Section 198, which allows the expensing of brownfield clean up costs, but is currently scheduled to sunset at the end of 2005.
- Broaden the definition of "hazardous substances" in Section 198 so it covers petroleum, pesticides, lead paint and asbestos contaminants.
- Repeal the provision in the law requiring the recapture of the Section 198 deduction when the property is sold.

Making Section 198 Permanent

Redevelopment of existing sites and properties is an important component of any community's development plans. The U.S. Conference of Mayors estimates that there are up to 600,000 brownfield sites across the country. The Government Accountability Office calculates that there are up to one million abandoned or underutilized sites. Development of these sites would help restore many blighted areas, create jobs where unemployment is high and ease pressure to develop beyond the fringes of communities. Small urban-centered businesses often benefit most directly by this redevelopment. Many brownfield properties are located in inner cities -- precisely where many businesses want to be. The economics are often right. Critical infrastructure, including transportation, is already in place and the workforce is in close proximity.

The Community Renewal and Reinvestment Act of 2000 removed the geographic targeting requirements of Internal Revenue Code Section 198. This allowed developers of brownfields to expense the cleanup costs wherever brownfields are located. Prior to this change, these clean up costs had to be added to the purchase price of the land ("capitalized") unless the contaminated site was located in an empowerment zone or other designated low-income area.

Capitalization means there is no deduction available for these expenses until the property is sold. Since this could be several years, this increases the overall tax burden of the redevelopment project. This higher tax burden hinders redevelopment efforts — particularly in areas that need them most.

We are pleased that in 2000 Congress determined that these clean up costs should be deductible in the year they are incurred and do not have to be capitalized. However, for revenue reasons, Congress has scheduled the expensing provision to expire in 2005. We strongly believe cleanup cost expensing for all brownfields should be extended permanently.

Broadening the Definition of "Hazardous Substance"

In addition to extending Section 198 permanently, we also believe Section 198 should be amended to work more as Congress intended. One such amendment would be to broaden the types of hazardous substances that are eligible for expensing treatment to include petroleum, lead paint, asbestos and pesticides.

The current version of IRC Section 198 relies on the term “hazardous substance” used in the Superfund law (CERLCA) to identify which contaminated sites would be eligible for tax relief: Section 198(c)(1)(A)(iii) defines a “qualified contaminated site” as one “at or which there has been a release (or threat of release) or disposal of hazardous substance.” The term “hazardous substance” is defined in Section 198(d)(1) to have the same meaning as in sections 101(14) and 102 of CERCLA. Section 198(d)(2) further states that the term “hazardous substance” shall not include any substance for which a removal or remedial action is not permitted under section 104(a)(3) of CERCLA.

At first blush, it appears logical for the drafters of Section 198 to simply borrow the term “hazardous substance” as used in CERCLA, the principal federal statute concerning environmental remediation, rather than coming up with a new term or a new definition. But, the problem created by this approach is that it assumes that the CERCLA definition of the term is broad enough to encompass all types of toxic materials that might be found at a brownfield site. That is not the case.

When CERCLA was adopted in 1980, Congress made the decision that it did not want the federal Superfund used to clean up certain types of substances – such as petroleum and various pesticides. Similarly, Superfund money was not to be spent cleaning up the interiors of buildings. While the decision not to authorize the spending of federal funds on these types of cleanups had significance for the administration of the Superfund program, the same rationale does not apply to a statute intended to provide a tax incentive to private parties cleaning up brownfield properties.

When CERCLA was adopted in 1980, the term “hazardous substances” was expressly defined to exclude “petroleum.” Also, although the term “hazardous substance” was defined to include a variety of substances considered toxic under various other environmental laws, it did not include most pesticide products and a variety of other toxic materials.

There were various reasons for the decision to exclude from the definition of "hazardous substance" certain materials which are nonetheless considered toxic. In the case of petroleum contamination, for example, Congress made a decision to rely on other statutory mechanisms to effectuate cleanups. In 1984, Congress adopted subtitle I of the Resource Conservation and Recovery Act ("RCRA"), 42 U.S.C. Section 6991, et seq., which addressed the cleanup of releases from underground storage tanks, many of which contain gasoline, fuel oil, or other petroleum products. In 1990, Congress adopted the Oil Pollution Act, 33 U.S.C. Section 2701, et seq., to address oil pollution into navigable waters. Thus, the exclusion of "petroleum" from the CERCLA definition of "hazardous substances" was not an indication that Congress believed that petroleum pollution did not need to be cleaned up. Petroleum simply was covered in other statutes.

Petroleum and pesticide pollution are common at brownfield sites. Petroleum products in the forms of fuel oil, heating oil or gasoline, were often used at these sites. Indeed, these materials were often stored in above-ground or underground tanks. Also, some of these sites have been contaminated by migrating gasoline spills from nearby service stations.

Pesticide residues are also frequently found at brownfield sites. Pesticides were often used to control weeds or insects at these sites when they were operating industrial plants. Moreover, some of these sites may be contaminated by pesticides run-off from other properties. While it may make sense not to authorize the use of federal funds under the Superfund program to clean up petroleum and pesticides, these substances often have to be cleaned up at brownfield sites before those properties can be returned to beneficial use. There is no reason not to extend the same type of tax incentive to a private party who is cleaning up petroleum waste or pesticide residues on a brownfield site as to one who is cleaning up other types of contaminants.

Asbestos and Lead Paint

Also, Congress in adopting CERCLA in 1980 did not want EPA to spend Superfund dollars cleaning up the interior of buildings. Accordingly, Congress adopted section 104(a)(3)(B) of CERCLA which prohibited EPA from cleaning up the interior of structures. Congress did not accept this limitation because it believed that contaminated interiors did not require cleanups. Rather, Congress believed that the use of the limited funds set aside for Superfund cleanups should be prioritized to deal with contamination that had escaped into the general environment. Once again, Congress used other federal programs to address interior contamination, such as the asbestos regulations under the Clean Air Act.

IRC Section 198, as currently drafted, states that the term “hazardous substance” does not include a substance that EPA would not be permitted to cleanup under section 104(a)(3) of CERCLA. Because of the applicability of the limitation in subsection 104(a)(3)(B), no expensing is allowed for the removal of asbestos, lead paint or other hazardous materials inside the buildings that are located at otherwise qualified sites. But brownfield restoration often involves the cleanup of existing buildings on the property. Expensing of costs to clean up buildings would give developers more reason to invest in brownfield properties. Thus, the expensing treatment IRC section 198 should be expanded to cover the removal of hazardous substances from buildings.

Recapture

Finally, another improvement that H.R. 877 would make to Section 198 is to repeal the recapture requirement of Section 198(e). Currently, any qualified environmental remediation expenditure expensed under Section 198 is subject to recapture as ordinary income when the property that was contaminated is sold or otherwise disposed of.

In effect, the amount expensed as a cleanup cost is treated as depreciation on IRC Section 1245 property. Thus, when the property is sold, gain to the extent of the cleanup cost deduction is treated as ordinary income.

Example

In 2001, Owner purchased an acre of land that was contaminated with a hazardous substance. The land cost $10,000 and Owner spent $5,000 in remediation expenses. Currently, he is allowed to claim a current deduction for the $5,000 instead of adding it to his basis in the land. If he sells the land for $16,000, he would be required to treat $5,000 of his $6,000 gain ($16,000 sale proceeds less $10,000 cost) as ordinary income taxable at 39.6%. The remaining $1,000 gain would be taxed at 20%.

When Does Recapture Matter?

In the example above, if Owner sold the land the year after he cleaned it up, he would receive little or no benefit from having deducted the clean up costs. This immediate repayment to the government leaves Owner with little tax incentive to clean up the property.

We believe that a more appropriate result would be to treat any gain in excess of Owner's original investment/acquisition cost in the property ($5000 in this case) as capital gain by repealing the recapture requirement. This provides an incentive for Owner to clean up the property without having the deduction effectively rescinded after the improvement is made.

If the clean up expenditure were recaptured as a capital gain, rather than as ordinary income, each party is in a stronger position. It would allow the government to recover a portion of its tax incentive from the developer, the developer retains a significant incentive for bearing the expense and associated risks of the cleanup activity, and the community receives an improved property with the prospect of job creation.

This treatment would be particularly helpful for entrepreneurs who acquire brownfield properties with the intent of remediating the contamination and then selling the improved property shortly thereafter. If a developer were to acquire a brownfield, clean it up and restore it to a viable market use, but then immediately lose the benefit of the cleanup deduction at the time of sale, the developer is left with little, if any, incentive effect. If the recapture provision were repealed, Section 198 would become a far better redevelopment incentive than it is now.

Conclusion

In conclusion, ICSC and the Roundtable urge Congress and this committee to explore the beneficial tax incentives as I have discussed. We believe that a tax credit approach could stimulate economic revivals in numerous communities and we encourage this committee to seriously consider such an approach. In addition, we specifically endorse H.R. 877 and the Brownfield Revitalization Act of 2005, formerly H.R. 4480. If Congress passes these sound incentive proposals, the result will be the injection of new capital into rehabilitation projects. Many small, urban centered businesses will benefit resulting in substantial job creation and economic revitalization. Also, the viability of existing sites will improve and ease the pressure to develop "greenfields" allowing for the preservation of more open space.

Because of the wide diversity in circumstances at the hundreds of thousands of brownfield sites in America, it should be clear that one size does not fit all. Therefore, a range of incentives would be the optimal solution. Tax credits, expensing, grants and revolving loans may all have their place, depending on the project, the local government's technical and financial capability, the surrounding community's needs.

I thank the Chairman and the members of the committee for this opportunity to appear before you today.